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# EU-25

# Dairy and Products

# Annual

# 2005

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**Report Highlights:**
EU dairy markets are stabilizing after the accession of the ten New Member States and new market dynamics are becoming clear. Investments to upgrade industry to EU standards turned the Czech Republic, Lithuania and Poland in a strong competitive position and milk production is increasing. From MY 2006/07, the implementation of the agreed milk production quota increases is also expected to lead to higher milk production.

Strong domestic cheese demands are expected to drain the entire protein content of increased milk supplies into cheese production. Changing consumer preferences for lower fat containing dairy products threaten the EU market with an oversupply of milkfat. Production of WMP and NFDM is expected to stagnate for lack of available milk supplies.

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# Table of Contents

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## Executive Summary

With accession of the 10 New Member States (NMS) well behind us, EU dairy markets are stabilizing again and lasting market dynamics become clearer. Milk production is increasing in the Czech Republic, Lithuania and Poland, while in some other NMS like Hungary, Slovenia and the Slovak Republic, which used to have higher dairy subsidy levels, the sector still has difficulties to adapt to the changed market conditions. Especially the Polish dairy processing sector appears to be very efficient because of the large investments to upgrade the sector to meet EU sanitary standards and because of the increase in milk deliveries to the industry. These three NMS have strong dairy production potentials and have found a vocation as sources of raw milk and semi-processed dairy products for industries in the EU-15, at least in the short term.

In the EU-15, milk production is expected to increase from 2006 on, as in 11 MS three previously agreed yearly consecutive 0.5 percent production quota increases kick in. Most, if not all, of this increase in milk supplies is expected to end up in cheese production for domestic consumption, at least the protein content of it. Changing consumer preferences for lower fat containing dairy products, including cheese, threaten the EU market with an oversupply of milkfat. As a result, pressure may build on the EU butter markets in the coming years, unless exports can be competitive on the world market. The production and export of Whole Milk Powder (WMP) is forecast to stagnate for lack of milk supplies. Non Fat Dry Milk (NFDM) production is not expected to change dramatically in the coming year, although it may vary depending on the export demand for casein at profitable prices.

**Fluid Milk**

| Country: | EU-25 | | | | | |
|---|---|---|---|---|---|---|
| Commodity: | Dairy, Milk (1000 Head / 1000 MT) | | | | | |
| | 2004 | | 2005 | | 2006 | |
| | Old | New | Old | New | Old | New |
| Calendar Year Begin | 01/2004 | | 01/2005 | | 01/2006 | |
| Cows In Milk | 23,963 | 23,963 | 23,382 | 23,398 | 0 | 23,050 |
| Cows Milk Deliveries to Dairies | 130,825 | 130,812 | 131,700 | 131,750 | 0 | 132,250 |
| Other Milk Production | 4,230 | 4,389 | 4,300 | 4,400 | 0 | 4,410 |
| Total Milk Production | 135,055 | 135,201 | 136,000 | 136,150 | 0 | 136,660 |
| Extra EU25 Imports | 2 | 2 | 3 | 2 | 0 | 2 |
| **TOTAL SUPPLY** | **135,057** | **135,203** | **136,003** | **136,152** | **0** | **136,662** |
| Extra EU25 Exports | 167 | 170 | 150 | 150 | 0 | 150 |
| Fluid Use Dom. Consum. | 34,237 | 34,306 | 34,403 | 33,702 | 0 | 33,550 |
| Factory Use Consum. | 100,653 | 100,727 | 101,450 | 102,300 | 0 | 102,962 |
| Feed Use Dom. Consum. | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Dom. Consumption | 134,890 | 135,033 | 135,853 | 136,002 | 0 | 136,512 |
| **TOTAL DISTRIBUTION** | **135,057** | **135,203** | **136,003** | **136,152** | **0** | **136,662** |

Sources: EU FAS Offices

EU-25 milk production is expected to be higher in 2005 and 2006, compared to 2004. However, this masks different developments in the individual Member States. In 2005, in the EU-15, French production is increasing after a marked decrease in 2004. German production is also increasing further despite large "superlevies" paid for over quota production in 2004. Milk production in Italy is continuing its long-term increase with farmers working to maximize their Single Farm Payment rights. Production in Austria, the Benelux and U.K. is declining in 2005. For 2006, decreasing milk production in the Benelux and the U.K. will expectedly be more than offset by increases in the other MS, particularly Germany and Ireland. In milk marketing year (MY) 2006/07[1], 11 MS from the EU-15 will receive the first of three consecutive 0.5 percent quota increases (see policy section). For MY 2004/05, ten out of the EU-15 Member States (MS) have to pay aggregate fines of €388 million of "superlevies" for overshooting their milk production quota by slightly over one million MT. More than 80 percent of this overshot came from Germany and Italy.

In the New Member States (NMS), production is increasing in 2005 as farmers benefit from increased milk prices after accession and because of a larger portion of milk production being delivered to the dairy industry. This is particularly true for milk production in the Czech Republic and Poland; while production in Hungary decreases because of lower price and support levels compared to pre-accession. Milk exports to Switzerland, North Africa and the Middle East are decreasing slightly. Consumption of milk is generally decreasing in the EU-15, as a result of the general increase in cheese consumption EU-wide, while consumption trends in the NMS vary somewhat from country to country.

[1] The EU marketing year for milk runs from April through March.

**Butter**

| Country: | EU-25 | | | | | |
|---|---|---|---|---|---|---|
| Commodity: | Dairy, Butter (1000 MT) | | | | | |
| | 2004 | | 2005 | | 2006 | |
| | Old | New | Old | New | Old | New |
| Calendar Year Begin | 01/2004 | | 01/2005 | | 01/2006 | |
| Beginning Stocks | 276 | 276 | 232 | 232 | 0 | 170 |
| Production | 2,150 | 2,154 | 2,145 | 2,155 | 0 | 2,160 |
| Extra EU25 Imports | 90 | 90 | 90 | 75 | 0 | 75 |
| **TOTAL SUPPLY** | **2,516** | **2,520** | **2,467** | **2,462** | **0** | **2,405** |
| Extra EU25 Exports | 347 | 352 | 350 | 360 | 0 | 365 |
| Domestic Consumption | 1,937 | 1,936 | 1,937 | 1,932 | 0 | 1,925 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL Dom. Consumption | 1,937 | 1,936 | 1,937 | 1,932 | 0 | 1,925 |
| Ending Stocks | 232 | 232 | 180 | 170 | 0 | 115 |
| **TOTAL DISTRIBUTION** | **2,516** | **2,520** | **2,467** | **2,462** | **0** | **2,405** |

Sources: EU FAS Offices

Butter production in the EU is expected to further increase slightly in 2005 and 2006, compared to 2004, despite the fact that cheese production is absorbing the entire increase in milk deliveries and NFDM production is decreasing. The reason for this is the trend for increasing consumption of low milkfat products. At the same time butter consumption in the EU is decreasing slightly further. Butter production is increasing in Germany, as cream imports from NMS (and more specifically Poland) are cheap enough to make butter production profitable. In France, increased milk deliveries lead to higher butter production. Increased butter production in Poland stems from increasing milk deliveries to the industry. These increases in butter production are partly offset by decreases in the Benelux, Ireland and the Scandinavian countries. The decrease in butter production in Denmark is triggered by the fact that some of the 30 thousand MT of butter imports from New Zealand, which are repacked in Denmark before being transshipped to the United Kingdom, end up on the domestic market.

As a result of this increase in butter production, increases in butterfat exports have to keep the EU butter balance in control, while butter imports are decreasing. In the first half of 2005, strong export demands for butter (+12%) and butteroil (+10%) allowed to dispose of excess butter. Export expectations for the second half of 2005 are dimmer because of the decrease in export refunds and because butter from Oceania is becoming available to world markets again. However, overall butter and butteroil exports in 2005 should exceed 2004 exports, thus helping to decrease butter intervention stocks. For 2006, a further increase in butter exports is forecast in anticipation of new butter price cuts and the resulting improved competitive market situation. This will expectedly allow to further decrease butter intervention stocks.

**Cheese**

| Country: | EU-25 | | | | | |
|---|---|---|---|---|---|---|
| Commodity: | Dairy, Cheese (1000 MT) | | | | | |
| | 2004 | | 2005 | | 2006 | |
| | Old | New | Old | New | Old | New |
| Calendar Year Begin | 01/2004 | | 01/2005 | | 01/2006 | |
| Beginning Stocks | 0 | 0 | 0 | 0 | 0 | 0 |
| Production | 6,345 | 6,430 | 6,420 | 6,500 | 0 | 6,550 |
| Extra EU25 Imports | 102 | 106 | 105 | 100 | 0 | 100 |
| **TOTAL SUPPLY** | **6,447** | **6,536** | **6,525** | **6,600** | **0** | **6,650** |
| Extra EU25 Exports | 500 | 515 | 510 | 485 | 0 | 500 |
| Domestic Consumption | 5,947 | 6,021 | 6,015 | 6,115 | 0 | 6,150 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL Dom. Consumption | 5,947 | 6,021 | 6,015 | 6,115 | 0 | 6,150 |
| Ending Stocks | 0 | 0 | 0 | 0 | 0 | 0 |
| **TOTAL DISTRIBUTION** | **6,447** | **6,536** | **6,525** | **6,600** | **0** | **6,650** |

Sources: EU FAS Offices

Cheese production in 2004 turned out to be higher than we had previously anticipated, as did exports and domestic consumption. This resulted from revised estimates of Greek data. Cheese production is expected to further increase in 2005 and 2006 driven by increases in domestic consumption. Cheese production in 2005 is mainly increasing in Germany, Denmark, United Kingdom, and Italy as Italian cheeses benefit from protection as Geographical Indicators (GI's) and increased volumes under storage aid. By contrast, French cheese production is on the decline in 2005, depressed by domestic demand. Consolidation of processing facilities is continuing in Ireland resulting in the closure of a cheese production plant. Cheese production, including cheese for further processing, is increasing in Poland because of strong EU demand. It should be noted that increased EU cheese production mainly means higher milk protein use and to a lesser extent increased butterfat use, because of increasing consumer preferences for low fat cheeses.

Cheese exports have reportedly been decreasing in the first half of 2005 by 30,000 tons, mainly because of the decrease in export refunds but they are expected to recover in the second half of 2005 as cheese prices may decrease. Domestic consumption of cheese is continuing its increasing trend in most MS throughout the whole EU. Interestingly, cheese is partially replacing meat and sausages in consumers diet in Germany and Poland. Demand for cheese is expected to further increase as cheese prices decrease. Consumption and production of soft and blue-veined cheeses in France is decreasing in 2005. For 2006, both consumption and production are forecast to continue to increase, EU-wide.

**Whole Dry Milk**

| Country: | EU-25 | | | | | |
|---|---|---|---|---|---|---|
| Commodity: | Dairy, Whole Milk Powder (1000 MT) | | | | | |
| | 2004 | | 2005 | | 2006 | |
| | Old | New | Old | New | Old | New |
| Calendar Year Begin | 01/2004 | | 01/2005 | | 01/2006 | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Beginning Stocks | 0 | 0 | 0 | 0 | 0 | 0 |
| Production | 850 | 857 | 840 | 860 | 0 | 855 |
| Extra EU25 Imports | 3 | 3 | 3 | 2 | 0 | 2 |
| **TOTAL SUPPLY** | **853** | **860** | **843** | **862** | **0** | **857** |
| Extra EU25 Exports | 510 | 514 | 500 | 495 | 0 | 490 |
| Domestic Consumption | 343 | 346 | 343 | 367 | 0 | 367 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL Dom. Consumption | 343 | 346 | 343 | 367 | 0 | 367 |
| Ending Stocks | 0 | 0 | 0 | 0 | 0 | 0 |
| **TOTAL DISTRIBUTION** | **853** | **860** | **843** | **862** | **0** | **857** |

Sources: EU FAS Offices

Production of WMP is expected to slightly increase in 2005 despite a reported decrease of 21,000 MT in exports in the first half-year. Increases in WMP production are being recorded in The Benelux, Denmark and mainly Sweden, where a NFDM production unit has been transformed and upgraded to produce WMP for exports. In Poland, WMP production is also increasing for exports. Decreases in WMP production mainly occur in the U.K. and France. Increasing WMP exports from Argentina and Oceania to Africa/Algeria and the Middle East are depressing European WMP exports. The increase in domestic consumption figures reflects some changes in commercial stock levels. WMP production and exports in 2006 are forecast to remain flat.

**Non Fat Dry Milk**

| **Country:** | **EU-25** | | | | | |
|---|---|---|---|---|---|---|
| **Commodity:** | **Non Fat Dried Milk** (1000 MT) | | | | | |
| | **2004** | | **2005** | | **2006** | |
| | Old | New | Old | New | Old | New |
| **Calendar Year Begin** | **01/2004** | | **01/2005** | | **01/2006** | |
| Beginning Stocks | 218 | 218 | 77 | 77 | 0 | 5 |
| Production | 1,090 | 1,066 | 1,090 | 1,050 | 0 | 1,060 |
| Extra EU25 Imports | 26 | 25 | 25 | 20 | 0 | 20 |
| **TOTAL SUPPLY** | **1,334** | **1,309** | **1,192** | **1,147** | **0** | **1,085** |
| Extra EU25 Exports | 285 | 282 | 270 | 225 | 0 | 200 |
| Domestic Consumption | 972 | 950 | 922 | 917 | 0 | 885 |
| Other Use, Losses | 0 | 0 | 0 | 0 | 0 | 0 |
| TOTAL Dom. Consumption | 972 | 950 | 922 | 917 | 0 | 885 |
| Ending Stocks | 77 | 77 | 0 | 5 | 0 | 0 |
| **TOTAL DISTRIBUTION** | **1,334** | **1,309** | **1,192** | **1,147** | **0** | **1,085** |

Sources: EU FAS Offices

Final 2004 production of NFDM was somewhat lower than we had previously anticipated, as was domestic consumption. Overall 2005 NFDM production is expected to decrease as a result of the cuts in intervention prices that were agreed in the 2003 CAP reform. While casein production was still increasing in the first half of 2005, the sharp reduction in the casein processing aid is expected to decrease casein production significantly in the second half of 2005. The reduction in export refunds is already hampering casein exports. As a result, more skimmed milk will be available for NFDM production in the second half of 2005. Another factor for the decline in NFDM production is the conversion of a Swedish production plant to WMP production. A milk powder plant in Denmark is reportedly closing down as a result of the new plant in Sweden too. Together with the depletion of intervention stocks, the reduction in NFDM production already resulted in a 35% percent decrease in export levels at mid 2005, compared to the same period of 2004. As a result, we lowered our previous NFDM export forecast.

For 2006, NDFM production is expected to increase, in line with butter production. NFDM export and domestic consumption are forecast to further decrease, as no stocks will be available anymore to compensate for the lack of production. NFDM use in feed has decreased significantly because of the reduction of subsidies for the incorporation of NFDM in milk replacers and its substitution by whey powder.

## Policy

*Decoupling of dairy aid in different Member States (MS)*

Decoupling of dairy aids from production was decided in the 2003 CAP reform. EU-15 MS could choose to decouple dairy aids between 2005 and 2007 at the latest. The implementing time of decoupling for different MS is available at http://europa.eu.int/comm/agriculture/markets/sfp/ms_en.pdf. As a result of the decoupling of dairy aids and the decrease in milk prices caused by lower intervention prices, small unprofitable dairy producers are expected to leave the sector. This is already materializing in several MS through an increase in quota mobility. However, with milk production remaining limited by quotas, which are not transferable between MS, the impact of decoupling on milk production is expected to be limited. Within MS, decoupling of dairy aid is expected to lead to a consolidation in milk production and the dairy processing industry. This consolidation in the EU dairy industry is reportedly necessary to generate the cost savings from economies of scale to compensate for the cuts in EU intervention prices of 15 percent for NFDM by 2006 and 25 percent for butter by 2007, and the reduced maximum ceilings for butter intervention of 30.000 MT by 2008.

In the NMS, consolidation is occurring as subsistence farms stop marketing milk on the farm and investments have to be made to meet EU sanitary standards for milk deliveries to the dairy industry. The Polish dairy sector is very efficient because of large investments that were made in the run-up to accession and the need to comply with EU sanitary standards. Dairies in the other NMS also had to upgrade to meet EU sanitary standards. This process is already on its way in Bulgaria and Romania also, as they will join the EU in 2007. Bulgaria has already called for a 6-month extension of the transition period for Bulgarian dairies to meet EU sanitary legislation.

*Quota increases*

As part of the CAP reform three consecutive yearly 0.5 percent quota increases were agreed in Regulation 1788/2003: (establishing a milk levy)[2] for those 11 MS that didn't receive quota increases under Agenda 2000 (Austria, Belgium, Denmark, Finland, Germany, France, Luxemburg, Netherlands, Portugal[3], Sweden and the United Kingdom) starting in 2006/07. Greece, Ireland, Italy and Spain had already increased production quota in previous years. While this increase in milk quota will expectedly be entirely absorbed by increases in domestic consumption, the EU will continue to be a net exporter of dairy products. The July

[2] http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_270/l_27020031021en01230136.pdf
[3] Portugal already received a quota increase in 2005 for Madeira and the Azores

2005 update of the EU Prospects for agricultural markets and income 2005-2012[4] increased the production forecast for cheese but also for butter for the coming years, while NFDM production forecast was lowered.

*Changes in dairy regulations*

The EC has proposed a new butter regulation, which will consolidate all existing butter regulations. This consolidation is reportedly aimed at making the whole butter Common Market Organization (CMO) more transparent and to allow better control. A few butter regulations for special domestic use schemes will be repealed, as they have not been used anymore in the past decade. EU industry sources are not expecting any significant market impact from this new, yet unpublished, regulation when approved.

*Evolution of EU export refunds and concerns about Doha trade round*

EU export refunds have been decreased significantly as an indirect result of the 2003 CAP Reform[5]. However, especially for butter substantial export refunds remain necessary for EU butter to compete on the world market.

| EC Export Refunds | March 11, 2004 | March 10, 2005 | October 13, 2005 | Oct2005/Mar2004 |
|---|---|---|---|---|
| Butter 82 % | €168/100kg | €136.5/100kg | €98.75/100kg | -41% |
| SMP | €54.5/100kg | €31/100kg | €12.49/100kg | -77% |
| WMP | €93/100kg | €0/100kg | €0/100kg | -100% |

Concerns are rising in Europe that the EU market could be swamped by dairy imports as a result of tariff concessions in the Doha trade talks.

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| E35001 | New EU Common Agricultural Policy starts in some EU countries | 1/3/2005 |

**United Kingdom**

| Report Number | Title | Date |
|---|---|---|
| UK5017 | UK dairy output forecast to sharply decline | 8/23/2005 |

4 http://europa.eu.int/comm/agriculture/publi/caprep/prospects2005/tabdairy.pdf
5 Export refunds are designed to compensate EU exporters for the lower price on the world market compared to the EU market and are established depending on market forces. The cuts in intervention prices that were fixed in the 2003 CAP reform led to lower prices on the EU market, and consequently to a smaller difference between the EU and world market price.

**Germany**

| Report Number | Title | Date |
|---|---|---|
| GM5028 | German dairy farmers face $163 million in superlevies for MY 2004/05 | 8/12/2005 |

**Italy**

| Report Number | Title | Date |
|---|---|---|
| IT5017 | EU protected cheeses in Italy - Production, storage aids and trade measures | 5/23/2005 |

**France**

| Report Number | Title | Date |
|---|---|---|
| FR5007 | Reportedly Butter Stocks at Dangerous Levels due to 2003 CAP Reform | 5/11/2005 |

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